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Initial Evidence of Corruption Risks in Government Oil and Gas Sales

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In many oil-producing countries, the government receives a physical share of production, and that oil is then typically sold by the national oil company (NOC). These trading transactions are currently subject to limited regulation and even fewer reporting requirements.

NRGI has argued for some time that these physical oil trading transactions merit greater transparency and oversight, for two reasons. First, the sales are economically important. For countries such as Iraq, Libya and Nigeria, oil sales have in past years generated over half of total government revenues. From 2011 to 2013, oil sales by the governments of Africa's top ten producers totaled $254 billion, an amount equivalent to 56 percent of those countries' total public revenues.[1]

Second, as with other high-value transactions in the extractive sector, the sales are susceptible to corruption.[2] To illustrate what these corruption risks look like in practice, this briefing summarizes 11 real-world situations where corruption or the perception of corruption arose around NOC oil and gas sales.[3] While achieving a comprehensive understanding of corruption risks in NOC commodity sales requires further analysis (as detailed in our conclusion), this briefing provides some initial evidence that these risks are real; subdivides the risks into three distinct stages of the sale process; and offers preliminary ideas about the type of policy response that is warranted.

Global recognition of the need for trading transparency is growing. Some initial steps toward advancing extractive sector transparency, such as the original Extractive Industries Transparency Initiative (EITI) requirements as well as mandatory payment reporting rules recently legislated in the US, EU, Norway and Canada, did not incorporate trading transactions. But several actions have recently arisen to address this gap. At the May 2016 anti-corruption summit hosted by the UK government, eleven countries and the European Commission committed to "enhance company disclosure" of payments to governments for the purchase of oil, gas and minerals.[4] These included Switzerland and the UK, which are home to many trading companies, and oil producers Ghana and Nigeria. The OECD has acknowledged trading corruption risks, and EITI and the IMF are calling for greater transparency in these transactions. For a summary of these advances and

1 For information on the economic importance of oil sale revenues, see Alexandra Gillies, Marc Guéniat and Lorenz Kummer, *Big Spenders: Swiss trading companies, African oil and the risks of opacity* (NRGI, 2014).
2 In line with many others, we define corruption as the use of public office to attain private gains. It can, therefore, include both activities that are technically legal and activities that are illegal.
3 A few of the cases are about the movement of refined products. The players and deals are similar enough that they provide useful illustrations.
4 NRGI. Who Committed to What in Extractives at the U.K. Anti-Corruption Summit?, 20 May 2016.

recommendations on what actions are needed, see the May 2016 briefing on transparent trading from NRGI and Publish What You Pay.[5]

Concerns around corruption and public accountability have partly driven this surge in attention to oil sales, and are the focus of this piece. However, commodity sales by NOCs also touch on important security, conflict and geopolitical agendas. For example, contested governmental entities, such as the Kurdistan Regional Government in Iraq and various factions in Libya, have sold oil to international buyers.[6] In other cases, stolen oil, which is often sold for export, has fueled conflicts in Iraq, Syria and Nigeria—a practice that bodies like the Financial Action Task Force (FATF) have begun to scrutinize. Oil sales have been subject to sanctions in countries like Libya and Iran, and sometimes NOC transactions have violated those sanctions. Greater transparency in the physical oil trades executed by governments could decrease risks across these areas as well.

The examples of corruption risks provided below serve two purposes. First, they show the risks of non-transparent sales systems and thereby demonstrate the importance of achieving greater openness and accountability in government oil and gas sales. While the examples are historical, the need for greater safeguards against corruption is very much current. Resource-rich governments are negotiating major, high-stakes deals for their non-renewable oil and gas resources. These include the sale of oil to repay large oil-backed loans – an opaque type of deal used by many resource producers to weather the oil price downturn.[7] Second, the examples point to the kinds of transparency that are needed. For instance, some of the cases suggest that disclosure of the beneficial owners of companies that buy oil from governments could deter the participation of politically exposed persons in trading deals. Other cases point to the need for sale-by-sale data disclosure, rather than aggregate figures. These preliminary observations can inform discussions by trading companies, governments in countries in which they are domiciled, and governments of producing countries as they identify optimal transparency measures.

CASE STUDIES

Corruption risks appear at several stages of the process by which governments and NOCs sell their oil and gas. The examples below fall roughly into three categories:

1. Selection of buyers
2. Negotiation of terms
3. Transfer of revenues

The summaries draw entirely on publicly available information.[8] Several of the deals described below have led to convictions. Several others prompted suspicion or controversy, but did not lead to conclusive legal action or final judgments. This could be because, in general, anti-corruption law enforcement activity has been less frequent around trading than other parts of the oil and gas sector, such as upstream procurement. **We do not suggest that the actors in these latter cases have engaged in**

5 5 NRGI and Publish What You Pay. *Transparent Trading* (2016).

6 Anjli Raval, "Libya warns shipowners over oil deals," *Financial Times*, 5 February 2016; for data on recent KRG sales, see "Kurdistan Regional Government Ministry of Natural Resources Press Releases," accessed on April 28, 2016: http://mnr.krg.org/index.php/en/media-center/press-release.

7 Examples include the new lines of credit or loan renegotiations secured by countries such as Angola, Chad, Kazakhstan and Venezuela.

8 The case material is drawn from a larger research project by NRGI on the mechanisms of extractive sector corruption. Commodity trading is one area of focus, alongside others including the allocation of licenses, subcontracting, state-owned companies, beneficial ownership concerns, and enabling professionals.

illegal activity—indeed their actions may have been entirely lawful. However, all of the cases in this briefing illustrate the types of costly perceptions and allegations that can arise in transactions involving secrecy and governmental discretion; investors, treasuries and citizens alike often bear these costs.

1. Allocation of buyers' rights

Just as in awards of other valuable government contracts, the allocation of the rights to buy oil or gas from NOCs can attract corrupt behavior. The problems can include bribery by companies in order to secure business, conflict of interest behavior by officials in charge of allocations, and the allocation of rights to companies with politically exposed persons (PEPs) as their beneficial owners.

The cases highlight the importance of open, competitive and rule-based allocation processes. They also suggest that transparency around the identity of the buying companies would enable oversight actors to ask further questions about the integrity of the selection process and which individuals stand to benefit from the sales. A basic payment reporting regime, implemented either by the NOC or the buying companies, would provide somewhere to start simply by naming the companies that are doing business with the NOC. It could also potentially reveal any special payments made by companies to government entities in order to secure new business. The cases indicate that a more robust approach would involve the disclosure of beneficial ownership information. A producing country could collect this information as part of a sector-specific company registry, such as those that EITI now requires implementing countries to establish.[9]

Fossus Energy-Indonesia bribery case

This case is a straightforward illustration of how bribery can infiltrate the process of selecting which companies will buy oil from a government. In 2013, Rudi Rubiandini, the chair of Indonesia's oil and gas regulator SKK Migas, approved the award of rights to the company Fossus Energy to buy portions of the government's share of production from three oil fields. Indonesian anti-corruption police arrested him shortly thereafter, on allegations that Fossus Energy paid him an approximate $1.1 million bribe in exchange for the rights. He reportedly received the money via a middleman (his golf trainer) and the manager of Kernel Oil, a sister company of Fossus Energy.[10]

Following a high-profile trial, an Indonesian court sentenced the Kernel Oil manager and Rubiandini to prison for bribery.[11] The trial did not uncover clear evidence that Fossus Energy bought the oil at depressed prices, though the $1.1 million Rubiandini received is a lost margin that the government could have captured. Rubiandini testified that the kickbacks were needed to meet demands from parliamentarians for "holiday bonuses," though lawmakers have denied the allegation.[12]

9 For more on EITI beneficial ownership requirements, see "Beneficial Ownership," accessed June 15, 2015: https://guide.eiti.org/en/topic/beneficial-ownership.

10 Hans Nicholas Jong, "Kernel Exec Sentenced to Three Years for Bribing Rudi," *Jakarta Post*, December 20, 2013.

11 Indonesia Investments, "Corruption in Indonesia: Rudi Rubiandini Guilty of Receiving Bribes," April 29, 2014.

12 I. Made Sentana and Deden Sudrajat, "Further Corruption Probe Seen for Indonesian Oil and Gas Regulator," *Wall Street Journal*, April 30, 2014.

Gunvor-Republic of Congo oil marketing controversy

Suspicious payments also drew the attention of law enforcement in this case, which involved the methods used by an employee of the Switzerland-based trading company Gunvor to secure oil sales business opportunities in the Republic of Congo. Between 2010 and 2012, a business development manager for Gunvor reportedly oversaw $30 million in payments to the Swiss bank accounts of two shell companies respectively controlled by a French trader and a former adviser to deceased Gabonese president Omar Bongo.[13] The trader and adviser reportedly helped secure meetings for Gunvor employees with top Brazzaville officials, including President Denis Sassou-Nguesso, as part of the large Swiss trader's effort to grow its Africa business. Following these meetings, Gunvor secured rights to purchase around 18 million barrels of crude oil from the Société Nationale des Pétroles du Congo (SNPC), Congo's NOC.[14] Gunvor went on to provide the Republic of Congo with a $750 million oil-backed loan to help build oil infrastructure. The basic structure and terms of the loan were not disclosed by the parties and it is unclear how the funds were used.[15]

After an official at the Swiss bank reported the $30 million in payments to regulators, the Swiss attorney general froze the two companies' accounts and opened an investigation into whether the trader and adviser had funneled money to Congolese officials. The Gunvor business development manager, rather than Gunvor itself, was the subject of the investigation.[16] Gunvor reportedly assisted the probe and has denied any wrongdoing or contemporaneous knowledge of the payments, claiming that the business development manager orchestrated them on his own.[17] Gunvor also fired the manager, and the two sides filed lawsuits against each other.[18] In 2012, prosecutors charged the manager with negotiating and overseeing a bribery and money laundering scheme. While no outcome to the court case has been announced, the series of events illustrates how bribery or the perception of bribery can arise as companies maneuver to secure oil purchase rights from governments.

Sphynx-Republic of Congo case

Along with bribery risks, the selection of oil buyers can also result in the allocation of lucrative business opportunities to companies owned at least in part by PEPs, which in turn raises issues of conflict of interest. In the early 2000s, SNPC regularly sold portions of the state's oil to three intermediary companies: Sphynx UK, Sphynx Bermuda and the local Africa Oil & Gas Corporation (AOGC). These companies paid the government for the oil after re-selling it to large international traders. SNPC channeled crude through Sphynx and AOGC allegedly in part to conceal state earnings from creditors, to whom Congo owed over $8 billion by 2005.[19] The scheme came to light when one US-based creditor attempted to enforce a $121 million judgement against the government.[20]

13 Agathe Duparc, "L'affair Gunvor ou l'anatomie d'un scandale petrolier russo-congolais," *Le Monde*, June 3, 2013.
14 Sylvain Besson, "Comment le Congo a fait chuter un prince du pétrole genevois," *Le Temps*, October 19, 2012.
15 Agathe Duparc, "L'affair Gunvor."
16 Javier Blas, "Swiss probe former Gunvor employee," *Financial Times*, July 4, 2012.
17 *Ibid.*
18 Agathe Duparc, "L'affair Gunvor."
19 "Sphynx Bermuda Ltd.," accessed April 28, 2016: https://star.worldbank.org/corruption-cases/node/18793.
20 *Kensington International Ltd v. Republic of Congo and others*, Queens Bench Division (Commercial Court), Judgment of Cooke, J., EWHC 2684 (Comm), November 28, 2005.

Some evidence suggests the intermediary companies may also have been used to distribute sale proceeds to politicians. NGO investigations found that a senior SNPC official owned large concealed stakes in all three companies,[21] and that some of the companies made exorbitantly high-interest loans to SNPC in exchange for discounted oil.[22] The government also granted AOGC interest in at least five Congolese oil fields at undisclosed prices.[23] Finally, Sphynx Bermuda reportedly paid companies owned by a family member of the president for unknown "consulting services."[24] Weak transparency in the buyer selection process and the absence of information about the companies' beneficial owners increased the risks of corruption, and contributed to a context where accusations and suspicions of this kind could arise.

Trafigura-Do Nascimento joint ventures in Angola

This example from Angola also shows how governments sometimes allocate trading business opportunities to companies with politically exposed participants, and how those entities then partner with international companies. Starting in 2009, the Angolan NOC Sonangol tapped the Swiss trading giant Trafigura to run two large fuel supply deals. The first was an oil-for-refined products swap arrangement under which Trafigura imported millions of tons of fuel annually. Under the second, the government hired Trafigura to market billions of dollars in gasoline and other products in Angola.[25] Through networks of shell companies, the Bahamian entity Cochan Ltd. held large stakes in the two Trafigura affiliates that contracted with Sonangol for the deals. Cochan's sole shareholder was a powerful senior aide to the Angolan president.[26]

This is a good example of a case where, at a minimum, the perception of corruption has arisen which may pose reputational risks to the companies involved. Both deals started while the senior official was in office. It was journalists, rather than the government or any private party, who first named the senior aide as Cochan's beneficial owner.[27] One journalist filed a complaint about the matter with the Angolan attorney general, but no law enforcement action followed.[28] Together, the two deals gave Trafigura and Cochan monopolistic control over the Angolan fuel market with unclear costs to the state—terms and payments of the deals were not disclosed.[29] Over time, Trafigura and Cochan have expanded their joint interests into Angola's ports, mines, roads and rail lines, and are collaborating in neighboring countries.[30] Sonangol itself bought into one of the Trafigura affiliates in 2011, further blurring the lines between state and private business.[31]

21 *Ibid.*
22 Global Witness. *The Riddle of the Sphynx: Where Has Congo's Oil Money Gone?* (Global Witness, 2005), 12.
23 *Ibid.*
24 "Sphynx Bermuda Ltd."
25 Berne Declaration. *Trafigura's Business in Angola* (Berne Declaration, 2013), 1-2.
26 Cochan Singapore Pte. *Annual Financial Statements 31 December 2011* (Ernst & Young, 2012), 8; Michael Weiss, "The 750 Million Dollar Man," Foreign Policy, February 13, 2014.
27 Christina Katsouris, "Angola: What's Behind Trafigura's Ejection from Products Swap," *Energy Compass*, September 21, 2012.
28 Michael Weiss, "The 750 Million Dollar Man," *Foreign Policy*, February 13, 2014.
29 Katsouris.
30 Puma Energy, "Press Release: Puma Energy Opens One of the World's Largest Offshore Fueling Facilities," April 21, 2015; John Grobler, "The bridge on the River Kasai," *Good Governance Africa*, September 1, 2014.
31 Weiss.

These four cases illustrate the corruption risks that are present when governments select which companies will buy government oil or gas in an opaque fashion. Two clear concerns are bribery by companies to secure an advantage, and allocation of buyer rights to companies in which PEPs have an interest. These concerns would subside if NOCs selected buyers using a transparent, competitive and rule-bound system—recommendations that mirror those made for other government selection and procurement processes. With respect to transparency, the cases reinforce the importance of knowing which companies buy oil from the state, the payments they made around these deals, and who actually owns and controls them.

2. Negotiation of terms

The terms of an NOC oil or gas sale determine whether the selling country receives the best possible value for its natural resources. A country could end up with suboptimal sale terms for several reasons: weak capacity and market analysis by the government or NOC; a lack of competition which keeps the government from discovering the highest available price; a government that prioritizes short-term returns over long term gains (e.g., with an oil-backed loan with costly repayment terms); or corruption. We focus on the last of these, and on the particular corruption risk of allocating preferential sale terms to favored companies that end up lowering the revenues received by the state.

Our research found cases that have prompted questions about whether NOCs offered buyers preferential, unbalanced or poorly defined terms that deviated from industry standards, such as:

- discounted prices on oil and gas sold
- unclear exchange rates for calculating sales values and payment amounts
- unusually long payment windows
- other technical calculations that reduce the buyer's payment obligations to the NOC
- concessionary credit lines, debt guarantees, or other non-standard financial support from the NOC to the buyer, either as terms of the sale or in side deals with the buyer

Given the complexity inherent in oil and gas trading, it is challenging for oversight actors like journalists or parliamentarians to spot suboptimal sale terms. However, the disclosure of the sale terms (most likely in a license or contract document) as well as sale-by-sale payment data could help. First, this data would help reveal outlier terms and sales, where the sale terms or prices realized noticeably depart from the norm. Second, this kind of transparency could increase the overall scrutiny of sale terms which could deter those engaged in various manipulations.

Philia-Republic of Congo refined product sales

In this case, questions arose around whether a trading company received favorable treatment from authorities in the Republic of Congo. Starting in 2013, a little-known Swiss entity named Philia Trading purchased at least $250 million in fuel and naphtha from Société Congolaise de Raffinage (Coraf), the Republic of Congo's state-owned oil refinery, and the Gabonese NOC Société Gabonaise de Raffinage (Sogara). Research by the Swiss NGO Berne Declaration found that Philia quickly re-sold, or "flipped," the products to established Swiss, UAE and UK trading companies (including a division of BP) for a profit margin instead of marketing and transporting them itself.

According to the NGO, Philia's sales contract with Coraf was not publicly tendered, gave the parties discretion to choose exchange rates for foreign currency conversions, allowed Philia an unusually long period in which to pay Coraf, and did not require Philia to post any security for the products it received. While noting that none of these terms were illegal per se, the NGO questioned whether Philia had received preferential treatment. Philia's sole shareholder was a Gabonese former-teacher who allegedly was a friend of the president's son, who also served as Coraf's general administrator. The son has publicly denied any link with the trader, though the recent Panama Papers leaks indicate his possible connections to Philia through correspondence to the law firm Mossack Fonseca regarding an offshore company.[32] Berne Declaration also claimed that Philia staff provided "private services of all sorts to the Congolese president's son, including recruiting future staff for the foundation he intended to create."[33] Philia disputed these claims, defending the legality and quality of the contract award process and stating it has no business ties to PEPs.[34] Thus far, there has been no legal action in the case. The case illustrates how perceptions of corruption can arise regarding the terms awarded to companies that hold oil trading deals, particularly where these deals are conducted in a secretive and discretionary manner.

Nigerian oil for product swaps

Another case of favorable contract terms comes from Nigeria. The administration of former president Goodluck Jonathan (2010-2015) entered into unbalanced deals with several oil trading companies. The companies that received the deals enjoyed political favor during this period, and were able to rake in sizeable profits thanks to the generous terms, which resulted in a major loss of public funds. Starting in 2010, the Nigerian National Petroleum Corporation (NNPC) sold 210,000 barrels per day of the country's crude through oil-for-refined-product swap deals with private trading companies. The deals consumed roughly a fifth of the government's share of oil production, a portion worth an estimated $35 billion in 2010 to 2014. Former officials justified the deals as necessary to avoid domestic fuel shortages.

While the swaps did help keep gasoline and kerosene flowing into Nigeria, research by NRGI found that some of the contracts were poorly structured and contained unbalanced or inadequately defined terms that allowed the traders to profit at NNPC's expense.[35] NRGI estimated that losses from three technical provisions in a single contract could have reached $381 million in one year (or $16.09 per barrel of oil traded). Some of the contract winners lacked fundamental trading capabilities, including the ability to market their own crude and source fuel directly from

32 Joan Tilouine, "« Panama papers » : comment le pétrole congolais s' évapore dans les paradis fiscaux," *Le Monde*, April 7, 2016.

33 Berne Declaration. *Philia's Refined Ventures in Brazzaville* (Berne Declaration, 2015).

34 The company claimed that Coraf awarded its fuel oil contract based on a competitive tender, Philia having offered the "best price and contractual conditions." The company also claimed that it "has no business arrangements with any politically exposed persons" in Congo, and that it actively and directly marketed the fuel oil cargoes it received from Coraf to "major oil refining companies." Philia SA, "Statement by Philia SA "Philia", relating to a report published by NGO Berne Declaration in March 2015 alleging misconduct by Philia in relation to its dealings with Congolaise de Raffinage "CORAF," Undated 2015.

35 NRGI's analysis focused specifically on three contracts: a refined product exchange agreement with Duke Oil Services signed in 2011, an offshore processing agreement (OPA) signed with Societe Ivoirienne d'Raffinage (SIR) in 2010, and another 2014 OPA with Aiteo Energy Resources. Other swap deals displayed at least some similar problems, but to lesser extents. For full details, see Aaron Sayne, Alexandra Gillies and Christina Katsouris. *Inside NNPC Oil Sales: A Case for Reform in Nigeria – Annex B: NNPC's Oil for Product Swaps* (Natural Resource Governance Institute, 2015.

refiners, yet were nonetheless chosen over more experienced traders to manage these large transactions. At that time, NNPC published almost no information about the deals; checks and balances to ensure the traders met their obligations were weak.[36] After a change in government, NNPC canceled the three swap contracts in mid-2015, stating that the contracts were "skewed in favor of the companies such that the value of product delivered is significantly lower than the equivalent crude oil allocated."[37] This case illustrates the potential for public revenue losses when major oil sale contracts disproportionately favor private interests.

Gazprom use of intermediaries

In other cases, politically well-connected companies receive oil trading deals that serve no obvious commercial purpose. Since the 1990s, Russia's majority-state-owned company Gazprom contracted with private intermediary companies to transport natural gas through its own pipelines from Central Asia and Russia to Ukraine.[38] A small pool of trading magnates controlled most of the companies, which were incorporated in OECD countries (Austria, Hungary, Switzerland and US). While these transport deals differ from the actual sale of commodities by NOCs, they still illustrate the potential for rent-seeking and public revenue losses when governments and NOCs enter into poorly structured physical commodity trading deals.

The parties appear to benefit greatly from the deals, sometimes at Gazprom's expense. For example, Gazprom has provided some of them with large loans, debt guarantees and other financial support—$880 million to one firm in a single year.[39] Analysis by the firm Hermitage, based on Russian Audit Chamber data, found that the Russian state-owned company lost an estimated $5.5 billion in pre-tax profit from a 2002 deal.[40] One of the intermediaries, OstChem, reportedly made more than $3.7 billion over two years.[41] Blurred lines between public and private interests in the deals have led to speculation by NGOs and journalists that Gazprom inserts middlemen into its gas transport supply chain to reward Ukrainian and Russian politicians, and possibly its own senior managers.[42] Some of the intermediaries' principals had business ties and/or official postings with three successive Ukrainian presidents from 1994-2014, creating potential conflicts of interest.[43] In one of several examples, in 1999 an executive of Itera, one of the intermediaries, testified in a US court that the company wired $25 million to an offshore company controlled by the former Ukrainian prime minister. This came at a time when the latter had legal powers to authorize Itera to supply gas to Ukraine through Gazprom's pipelines.[44] While less straightforward than a single contract with unbalanced terms, these gas transport deals illustrate how governments and NOCs sometimes choose to insert companies into deals for private or political motives, rather than with the aim of maximizing public revenues.

36 Aaron Sayne, Alexandra Gillies and Christina Katsouris. *Inside NNPC Oil Sales: A Case for Reform in Nigeria* (Natural Resource Governance Institute, 2015), 42-46.
37 NNPC, "Press Release - NNPC Cancels Contract for Delivery of Crude Oil to Refineries," August 26, 2015.
38 Isabel Gorst and Neil Buckley, "Report questions Gazprom strategy," *Financial Times*, June 2, 2005.
39 Paul Starobin and Catherine Belton, "Gazprom: Russia's Enron?" *Bloomberg*, February 17, 2002.
40 *Ibid.*
41 Stephen Grey, Tom Bergin and Sevgil Musaieva, "SPECIAL REPORT-Putin's allies channeled billions to Ukraine oligarch," Reuters, November 26, 2014.
42 Summarized in Global Witness. *It's A Gas: Funny Business in the Turkmen-Ukraine Gas Trade* (Global Witness, 2005).
43 *Ibid.*
44 Id. at 24.

When negotiating oil sale deals, some governments choose to allocate preferential terms to favored companies. Suspicions of this behavior arose in the Congolese, Nigerian and Russian deals described above. Unbalanced terms can directly reduce the return received by the country for its natural resources, and these losses can be sizeable given the high value of the sales involved. Transparency around the terms of the deal, and how they are executed on a sale-by-sale basis can disincentivize this kind of costly deal-making.

3. Collection and transfer of revenues

Once the NOC sells its oil, the resulting revenues can sometimes take a circuitous route to a country's treasury, and portions of the proceeds can be misdirected along the way. NOCs usually collect oil sale revenues themselves, and the amounts collected often remain secret. Our research pointed to instances of NOCs and other government agencies retaining billions of dollars in sales proceeds, including in non-transparent foreign accounts, and then spending much or all of the money "off-budget." Extra-budgetary spending of NOC oil sale revenues carries corruption risks because it avoids the checks and balances of the budget system (e.g., legislative approval).

To reduce these risks entirely will usually require structural reform. The fiscal relationship between the NOC and state should be clearly defined and subject to robust oversight, and any spending of public revenues by the NOC should be authorized by the national budget and subject to regular audits. Transparency can help in those contexts where such comprehensive NOC reform has yet to take hold. To lessen the corruption risks associated with off-budget NOC spending, the amount of money collected by the NOC must be disclosed. Then other government agencies, private investors, oversight actors such as parliaments and auditors, and civil society and the media can ask the company what it has done with the funds, and can compare the amount of gross receipts to whatever ends up entering the treasury.

Turkmenistan-Deutsche Bank offshore accounts

Past practices in Turkmenistan show just how absent transparency and accountability can be when a political leader asserts near total control over oil and gas sale revenues. Beginning in the 1990s, Turkmenistan kept nearly all of its earnings from NOC sales of oil and gas exports in foreign accounts, many of them at Deutsche Bank. The Turkmen government published no information about the accounts' balances, management or outflows. However, investigations found that these funds fed 75 percent of government spending; all of the expenditure was off-budget. In 2006 Global Witness estimated that the foreign accounts together contained roughly $3 billion.[45] Bafin, Germany's financial supervisory authority, investigated the matter and concluded there was no reason to believe that Deutsche Bank itself had broken international rules.[46]

45 Global Witness, *It's a Gas*, 4.
46 Hugh Williamson, "Deutche Bank admits to Turkmen accounts," *The Financial Times*, 9 May 2007.

Turkmenistan's then-"president for life" Saparmurat Niyazov reportedly maintained effective control over the accounts. His government spent large sums of oil and gas sale revenues on national prestige projects that were of little use to the general public and reinforced the president's "personality cult."[47] These included an opulent presidential palace and a rotating golden statue of the president that always faced the sun. Maintaining sole, secretive and discretionary control over the accounts, and the petroleum sale revenues they contained, helped the Niyazov regime, widely seen as one of the world's most autocratic and repressive, to consolidate power.[48]

Nigeria's "missing $20 billion" controversy

In Nigeria, the NOC was accused of discretionarily retaining and spending large shares of oil sale revenues, rather than transferring them to the government budget. Early in 2014, Nigeria's then-central bank governor Lamido Sanusi alleged that the Nigeria National Petroleum Corporation (NNPC) had failed to remit $20 billion in oil sale revenues to the treasury over a 19-month period.[49] Subsequently, various government actors offered at least five different versions of what happened to the money, none of which were definitive. PricewaterhouseCoopers, the auditors hired to review the relevant accounts, wrote that NNPC had a "blank cheque to spend money without limit or control. This is untenable and unsustainable and must be addressed immediately."[50]

NNPC did not provide a comprehensive explanation of the shortfall in its budgetary transfers, nor did it fully explain how it used the money. Enabled by secrecy and an absence of checks and balances around NOC spending, some of the "missing" funds were lost to corruption or waste. For example, NNPC made fuel subsidy payments for fuel that never entered the country and funded expensive and ineffectual programs to secure and maintain pipelines. A former oil minister, who exercised significant control over NNPC crude sales, is now under investigation for corruption in several jurisdictions (she has denied the allegations), as are some buyer companies.[51] Large sums also went to the office of a former national security adviser who is now in court over charges that he funneled $2.1 billion to power brokers and election propagandists using bogus government contracts.[52] Sanusi told parliamentarians that NNPC's habits of retaining and spending large sums of crude sale revenues complicated the central bank's efforts to protect the local currency, control inflation and maintain fiscal buffers.[53] When the global oil price tumbled in mid-2015, Nigeria lacked sufficient oil revenue savings, and must now rely on growing third-party debt to fund the national budget and NNPC's operations.

This case illustrates the corruption risks as well as the macroeconomic risks that arise when NOCs enjoy wide discretionary control over oil sale revenues.

47 "The personality cult of Turkmenbashi," *The Guardian*, December 21, 2006.
48 Global Witness, *It's a Gas*, 17.
49 Lamido Sanusi, "Unanswered questions on Nigeria's missing billions," *Financial Times*, May 13, 2015.
50 Sayne, Gilles and Katsouris, *Inside NNPC Oil Sales*, A15-A16.
51 Julia Payne and Felix Onuah, "Nigeria's ex-oil minister Alison-Madueke arrested in London – sources," *Reuters*, October 2, 2015; Julia Payne and Felix Onuah, "Nigeria arrests oil tycoon as corruption probe widens," *Reuters*, October 6, 2015.
52 For more information, see Aaron Sayne and Alexandra Gillies, *NNPC Still Holds 'Blank Check'* (Natural Resource Governance Institute, 2015), 6.
53 Lamido Sanusi, Memorandum Submitted to the Senate Committee on Finance on the Non-Remittance of the Oil Revenue to the Federation Account, February 2014, p.3.

Angola's $31 billion fiscal gap

As in Nigeria, Angola's NOC has retained a large share of oil revenues and engaged in extensive extra-budgetary spending. A December 2011 IMF report showed shortfalls in Angola's fiscal accounts between 2007 and 2010 amounting to $31.4 billion—or roughly a quarter of the country's GDP. Much of the unaccounted-for funds were linked to off-budget spending of oil sale revenues by the NOC Sonangol, which sells the government's share of production. The IMF noted that some funds went to foreign escrow accounts for unclear reasons.[54]

During a reconciliation exercise, the Angolan government explained that Sonangol engaged in large amounts of "quasi-fiscal" spending on its behalf. The NOC for its part claimed it retained oil revenues as "reimbursement" for such outlays. According to a subsequent IMF report, Sonangol bankrolled sizable public works projects and serviced public debt.[55] However, the report did not describe the projects in detail, or explain why the government chose to pay for them off-budget. No explanation was offered for $4.2 billion (14 percent) of the shortfall. The large scale of these revenues, their secretive management, and the avoidance of budgetary checks and balances all increase corruption risks where the NOC collects, retains and spends a large portion of oil sale receipts.

Iraq Oil-for-Food scandal

Between 1996 and 2003, certain traders taking part in the United Nations-monitored Iraq Oil-for-Food Program (OFFP) negotiated secret side payments to the Iraqi government in exchange for the oil they received. Actors involved in the scheme used shell companies, disguised corporate ownership, and offshore banking services to facilitate the payments. The four traders that made the most payments were Bayoil Supply and Trading[56], the Taurus Group, Glencore and Vitol. [57] This system of kickbacks generated over $1.8 billion for the Saddam Hussein regime.[58]

The payments led to at least six formal investigations. Most of the resulting law enforcement action, for bribery and related financial offenses, took place in the US. Investigations indicated serious gaps in United Nations oversight of the OFFP. For instance, one firm, the Africa Middle East Petroleum Company, admitted to wiring $160,000 to the personal account of an OFFP director in exchange for contracts—a claim the director denied.[59] The probes also found that the Hussein government spent much of the kickbacks it received on extravagant palaces and weapons, including a missile program that exceeded limits imposed by the UN Security Council.[60] The Oil-for Food scandal was unique in some ways, particularly given the large role played by an international agency in overseeing a country's oil export transactions. However, it illustrates more widespread trends, namely the ability of oil-rich governments to lure extra cash from companies that seek to buy its high-value exports.

54 International Monetary Fund (IMF). *Angola—Fifth Review Under the Stand-By Arrangement, Request for Waiver of Applicability of Performance Criteria, and Request for Modification of Performance Criteria* (IMF, 2011), 8-9.
55 IMF. *Angola—Sixth Review Under the Stand-By Arrangement, Request for Waivers of Nonobservance of Performance Criteria, and Proposal for Post-Program Monitoring* (IMF, 2012), 38-39.
56 Alan Feuer, "Texas Trader Admits Guilt in Iraq Oil-for-Food Fraud," *New York Times*, August 18, 2007.
57 Independent Inquiry Committee into the United Nations Oil-for-Food Program (Paul Volcker, chair). *Report on Manipulation of the Oil-for-Food Program by the Iraqi Regime* (2005), 3.
58 *Ibid.*
59 Lauren Rivera, "Former Oil-for-Food Chief Quits U.N.," *CNN*, August 7, 2005.
60 Colin Freeman, "Saddam Hussein's Palaces," *The Guardian*, July 16, 2009; Sharon Otterman. Backgrounder: IRAQ: Oil-for-Food Scandal (Council on Foreign Relations, 2005).

CONCLUSION

This briefing has offered real world examples of how corruption risks can arise in physical commodity sales by NOCs and other government actors. These risks can arise at different stages, including the selection of the buying company, the negotiation of the sale terms, and the utilization of the sale revenues. The examples show how the problems of bribery, conflicts of interest, self-dealing, favoritism, political interference and the misappropriation of public funds can all emerge in oil trading transactions.

A full understanding of corruption risks in commodity trading, and how to reduce them, will require further study. In the meantime, the examples presented here do provide further evidence for why transparency is needed in commodity sale transactions – across all three of the stages mentioned above—and the types of information that should be disclosed.

- First, in the selection of buyers, more information about which companies buy oil from NOCs, and how they were selected, would enable oversight actors to raise questions about why those companies where chosen, and whether it was a fair decision. Beneficial ownership data about buying companies would deter politically exposed persons and other problematic players (e.g., companies/individuals associated with corruption or crime in other jurisdictions) from participating in lucrative oil trading deals, and help expose those instances where this practice already takes place.
- Second, with respect to the terms of deals, citizens should be allowed to observe the return received when the NOC sells public resources. Because of similar concerns around accountability, Canada, the EU, Norway and the US have passed legislation that requires oil, gas and mining companies to disclose the payments they make to governments for extraction of resources. Trading payments, often larger in size than royalty or tax payments, should be treated the same way, with trading companies required by their home countries to report annually on any trading-related payments made to governments or NOCs. This kind of disaggregated, per sale data would shed light on the kinds of deals executed, especially if accompanied by the terms of deals as contained in the license or contract.
- Finally, the NOC and the government should report on how much revenue the NOC collects, and how these funds are transferred and used. Reporting is particularly urgent if some sale proceeds do not enter the treasury, and are instead spent off-budget by the NOC, so as to protect against misappropriation and wasteful or politically motivated spending.

For decades, the commodities trading sector operated largely in secret, but governments should no longer grant it that exception. The corruption risks in this sector are real and proven, and large amounts of public revenues are at stake. Greater transparency in NOC commodity sales would encourage public confidence and discourage the manipulation of these transactions and the misuse of the resulting proceeds.